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No. 865

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Supreme Court of the United States.

October Term, 1940.

Haffenreffer Brewing Company
v.
Commissioner of Internal Revenue.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the First Circuit
and
Brief in Support Thereof.

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Supreme Court of the United States.

OCTOBER TERM, 1940.

HAFFENREFFER BREWING COMPANY
v.
COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States.

Haffenreffer Brewing Company prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the First Circuit entered in the above-entitled case on December 23, 1940.

Jurisdiction.

The judgment below was entered December 23, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

By Section 351 of the Revenue Act of 1934 a surtax in the nature of a penalty was imposed on the "undistributed adjusted net income" of a personal holding company as

therein defined. In determining "undistributed adjusted net income" the law provided that there should be deducted "amounts used or set aside to retire indebtedness incurred prior to January 1, 1934."

This case presents the following questions of construction:

1. Must the indebtedness be evidenced by "a bond, note, debenture, certificate of indebtedness, mortgage or deed of trust . . ."?

2. Where the taxpayer corporation by written contract executed August 1, 1930, agrees to pay a certain percentage of its earnings in each year to retire its preferred stock, and the earnings in 1933 are such that it thereby becomes obligated to set aside and pay the sum of $86,400, and this sum is actually so paid and applied in 1934, is this amount "used or set aside to retire indebtedness incurred prior to January 1, 1934"?

Statement of Facts.

On June 27, 1930, the two stockholders of two corporations engaged in the brewing business entered into an agreement to form a corporation to acquire all the capital stock of these corporations, and a claim for moneys loaned by one of the stockholders to one of the corporations. The petitioner in this case was organized pursuant to this contract under the laws of Massachusetts, issued its preferred and common stock in exchange for the capital stock of the other corporations and for the said claim (R. p. 25). The petitioner also became a party to and adopted the said contract of June 27, 1930, on August 1, 1930 (R. pp. 9, 29). By the terms of said contract and by the provisions of the preferred stock issued in accordance with said contract, it was agreed that the petitioner should set aside in each year

a certain percentage of the net earnings of the corporation for such year as a sinking fund, and that the petitioner "shall have the right to and shall apply the sinking fund to the redemption of preferred shares at the par value thereof and accumulated dividends, or to the purchase of preferred stock at not to exceed the par value thereof and accumulated dividends . . ." (R. p. 27). The contract defined at length the manner in which net earnings were to be determined (R. p. 20).

During 1933 consolidated net earnings as defined in the by-laws of petitioner were such that the petitioner was required by the contract to which it became a party on August 1, 1930, and by the provisions of its preferred stock which was issued on August 1, 1930, to set aside the sum of $86,451.67 as a sinking fund for the purchase or redemption of its preferred stock (R. p. 29).

Early in 1934 the petitioner applied $86,400 for the retirement of the preferred stock in accordance with the provisions of the contract and the terms of its preferred shares (R. p. 29).

The Board of Tax Appeals, three members dissenting, held that this sum of $86,400 was not deductible, and this decision was affirmed by the United States Circuit Court of Appeals for the First Circuit, but on grounds different from those upon which the Board of Tax Appeals based its decision.

The grounds on which the Court below relied were in substance as follows:

1. Section 27 (a) (4) of the Revenue Act of 1938, relating to corporation dividends paid credit, provides:

> "As used in this paragraph the term 'indebtedness' means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the cor-

poration and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. . . ."

The Court below held that by analogy this definition governed the meaning of the word "indebtedness" as used in the provisions relating to surtax on personal holding companies.

2. The Court further held that payments by a corporation to retire preferred stock are not payments on account of an indebtedness, even if prior to January 1, 1934, the corporation incurred a fixed and absolute obligation to pay a definite sum of money to retire or purchase stock.

Reasons Relied on for the Allowance of the Writ.

1. The decision in this case is in conflict with the decision by the Circuit Court of Appeals for the Third Circuit in the case of *Commissioner* v. *Tennessee Co.*, 111 F. (2d) 678.

The Court below in the instant case attempts to distinguish the Tennessee case on the ground that that case dealt with promissory notes. The material portions of the instrument involved in the Tennessee case are set forth on page 6 of the brief attached to this petition, and it is respectfully submitted that it is clear beyond any doubt that the instrument involved in the Tennessee case was not a promissory note and did not in any material respect vary from the instrument involved in the instant case. True, the instrument in the Tennessee case was shrewdly or unwittingly miscalled a "promissory note," but the recent decisions of this Court lend no room for an argument that malapropism, deliberate or otherwise, is any sufficient basis for distinction in legal results.

2. The decision is in conflict with the great mass of decisions in the Federal Courts and in the Supreme Judicial Courts of Massachusetts to the effect that the relationship between a corporation and stockholder is transformed into a debtor-creditor relationship where by contract, vote to redeem, or the occurrence of any other contingency a corporation becomes subject to a fixed, definite or absolute obligation to pay a definite sum of money to purchase or retire preferred stock. Under such circumstances it is settled law that the obligation of the corporation with respect to such stock becomes an indebtedness just as it would if the stock were in form converted into bonds.

The authorities on this point are cited on page 9 of the brief attached to this petition.

3. The contention of the Court below that the indebtedness must be evidenced by a note or similar written instrument is not only in conflict with *Commissioner* v. *Tennessee Co.*, 111 F. (2d) 678, but with the plain language of the statute, the applicable regulations and a number of decisions of the United States Board of Tax Appeals.

4. The questions involved in this case are questions of general and continuing interest and importance.

Wherefore it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the First Circuit should be granted.

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PETITIONER'S

BRIEF

BRIEF IN SUPPORT OF FOREGOING PETITION.

Opinions Below.

The Opinion of the Board of Tax Appeals is reported in 41 B.T.A. 443, and is printed on pages 30-41 of the Record. The Opinion of the Circuit Court of Appeals is reported in 116 F. (2d) 467, and is printed on pages 50-63 of the Record.

Jurisdiction.

Reference is made to the foregoing petition for a statement of the jurisdiction of this Court and the statement of the case.

Argument.

In *Commissioner* v. *Tennessee Co.*, 111 F. (2d) 678, a corporation in 1933 executed an instrument the material portions of which are as follows:

> "*Promissory Note*
>
> The Tennessee Company . . . promises to pay to . . . the principal sum of . . . Dollars. . . . The payment of the principal of and interest of this note . . . shall be made only out of net earnings of the Company as hereinafter defined determined by the Board of Directors of the Company to be available for that purpose. 'Net Earnings' applicable to the payment of the principal of and interest on this note shall be the amount remaining after deducting from gross earnings and income of the Company from all sources for the fiscal year all expenses and charges for operation, taxes, interest, losses, depreciation, amortization and all reserves for any of the above purposes, and such

other reserves as may in the absolute discretion of the Board of Directors of the Company be determined to be expedient in the proper management of the business of the Company."

The Circuit Court of Appeals for the Third Circuit held that the amounts paid in 1934 on the above instrument out of the earnings of that year were deductible as payments on an indebtedness incurred prior to January 1, 1934.

As Judge Clark pointed out, the instrument was payable "when, as and if those earnings came into existence, and not otherwise . . ." An instrument is not a promissory note, negotiable or non-negotiable, unless it contains an absolute promise to pay a fixed sum of money at a definite time. This instrument was not a promissory note.

Uniform Negotiable Instruments Law, § 184, Mass. G.L. (Ter. Ed.) c. 107, § 207.
Coolidge v. *Ruggles,* 15 Mass. 387.
Sloan v. *McCarthy,* 124 Mass. 245.

"A note is not in legal effect the same as an ordinary contractual obligation to pay the amount named therein, even if non-negotiable."

Burdett v. *Walsh,* 235 Mass. 153, 155.

No substantial distinction can be found between the rights and liabilities incident to the security involved in the Tennessee case and those of the preferred stock involved in the case at bar; both securities were preferred stock, to which was attached a collateral contract which, on the occurrence of certain contingencies, transformed the obligation represented by the stock to an obligation of a debtor to a creditor.

Thus in *Commissioner* v. *Schmoll Fils Associated, Inc.*, 110 F. (2d) 611 (2 C.C.A.), a security, the incidents of which were quite similar to the security involved in the Tennessee case, was held to be preferred stock, although called by the parties "debentures"; and conversely in *Commissioner of Internal Revenue* v. *Palmer, Stacy-Merrill, Inc.*, 111 F. (2d) 809, a security called "preferred stock" was held to be an indebtedness because of a fixed obligation to redeem in installments.

In the absence of earnings, for example, a payment on the instrument clearly would have been a voluntary payment and not on account of an indebtedness. When, however, earnings accrued, a definite obligation did arise, and the decision in the Tennessee Company case is a decision that an amount paid in discharge of this obligation is deductible if the obligation resulted from a contract executed prior to January 1, 1934.

The case at bar is a far stronger case in favor of the taxpayer than the Tennessee case. Here the taxpayer agreed in substance to pay to its preferred stockholder a sum equal to a fixed percentage of its 1933 earnings. This obligation became fixed and absolute and was "incurred" in 1933, whereas in the Tennessee case the obligation did not become fixed and absolute until 1934.

United States v. *Anderson*, 269 U.S. 422, 441.

A decision in favor of the taxpayer in the Tennessee case is therefore wholly inconsistent with a decision adverse to the taxpayer in the instant case, although the reverse may not necessarily follow.

As stated by the Board of Tax Appeals in its opinion (R. p. 35), the petitioner's contention is "that regardless of whether the preferred stock as such was an indebtedness of the petitioner to the extent of its par value, the *obligation* of the petitioner under the terms of the contract to use

$86,451.67 of the 1933 consolidated net earnings in retirement of part of its preferred stock was an 'indebtedness incurred prior to January 1, 1934'."

In other words, while the relationship between a corporation and a preferred stockholder is not a debtor-creditor relationship, it may be transformed into a debtor-creditor relationship by a vote to redeem, or by a contract to purchase or by the occurrence of any contingency which creates a fixed obligation to redeem stock.

In *Pier* v. *Commissioner,* 96 F. (2d) 642, 651, Judge Haney said:

> "I think that upon notice of acceptance of the option, the preferred stockholders became creditors. . . . Upon declaration of a dividend by a corporation, the stockholder becomes a creditor. . . . I do not believe that, because it is left to the directors to fix the date of redemption, there is any distinction, *since once the date is fixed, the relation is the same.*" (Italics supplied.)

To the same effect see:

> *Scriggins* v. *Thomas Dalby Co.,* 290 Mass. 414.
> *Dustin* v. *Randall Faichney Corp. et al.,* 263 Mass. 99.
> *Crimmins & Pierce Co.* v. *Kidder Peabody Acceptance Corp.,* 282 Mass. 367, 376.

In an analogous situation the Court, in *Commissioner* v. *Proctor Shop,* 82 F. (2d) 792, said:

> "The controlling feature is the existence of the obligation, not its source."

Of course, it does not follow that any personal holding company may at any time create an indebtedness to be used

as a deduction by voting to redeem stock, since Section 351 of the Revenue Act of 1934 requires that the transformation from stock to indebtedness take place prior to January 1, 1934. There is nothing, however, in Section 351 which excludes from its remedial provisions any indebtedness arising before January 1, 1934, merely because the indebtedness arose out of stock of the corporation. There seems no rational distinction between a corporation whose preferred stock was converted into bonds prior to January 1, 1934, and a corporation which by vote or ordinary contract incurred an obligation to purchase stock, at least when this obligation became fixed and absolute before January 1, 1934.

Thus the inchoate right of stockholders to earnings is not an indebtedness, but may be transformed into an indebtedness by a declaration of a dividend, and if the dividend is not paid when due, interest accruing on the dividend thereafter is deductible as interest on an indebtedness.

> *Commissioner* v. *T. R. Miller Mill Co.*, 102 F. (2d) 599.

Thus the Regulations (Art. 23 (b) (1), Reg. 101) allow interest paid on script dividends as a deduction of interest on an indebtedness.

Prior to the decision in the instant case the Government had abandoned any contention that "indebtedness" as used in the provisions of the 1934 and subsequent acts imposing a surtax on personal holding companies was confined to indebtedness evidenced by any particular form of instruments.

See *American Foundation Co.* v. *Commissioner*, 40 B.T.A. 542, where the Board of Tax Appeals in its opinion noted this change in the position of the Government, and held that a debt evidenced by a judgment was an "indebtedness" within the meaning of the law.

Again, the Board of Tax Appeals has recently held in *Floyd, Inc.*, v. *Commissioner*, 43 B.T.A. No. 16, promulgated December 18, 1940, that an obligation for taxes was an "indebtedness."

Finally, the regulations applicable to the surtax on personal holding companies do not require that the obligation be evidenced by a promissory note or similar instrument, and otherwise differ substantially from the regulations promulgated in connection with the provisions relating to dividend credits contained in Section 27 (a) (4) of the Revenue Act of 1938.

For the foregoing reasons it is respectfully submitted that this petition for writ of certiorari should be granted.

Respectfully submitted,

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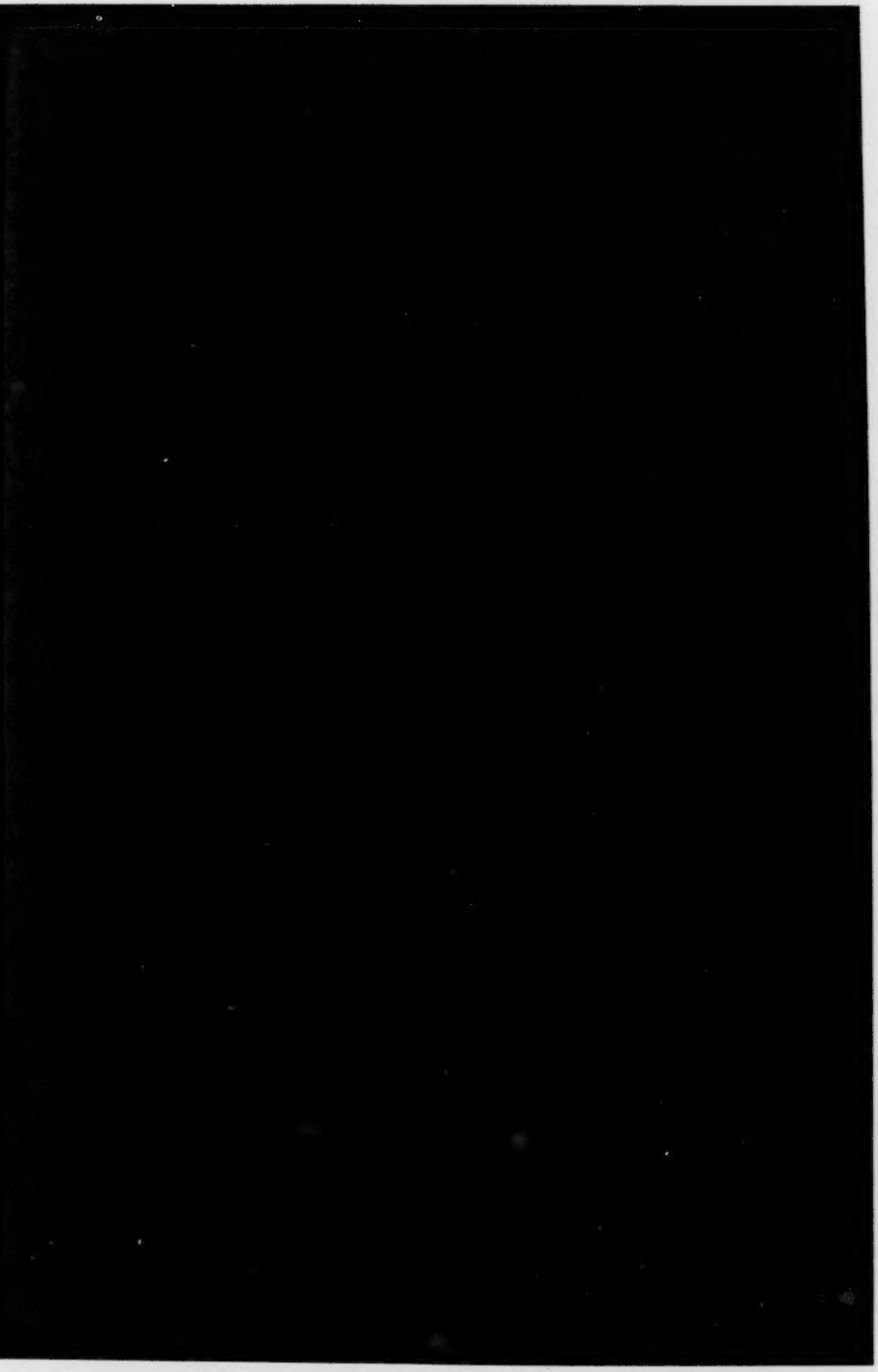

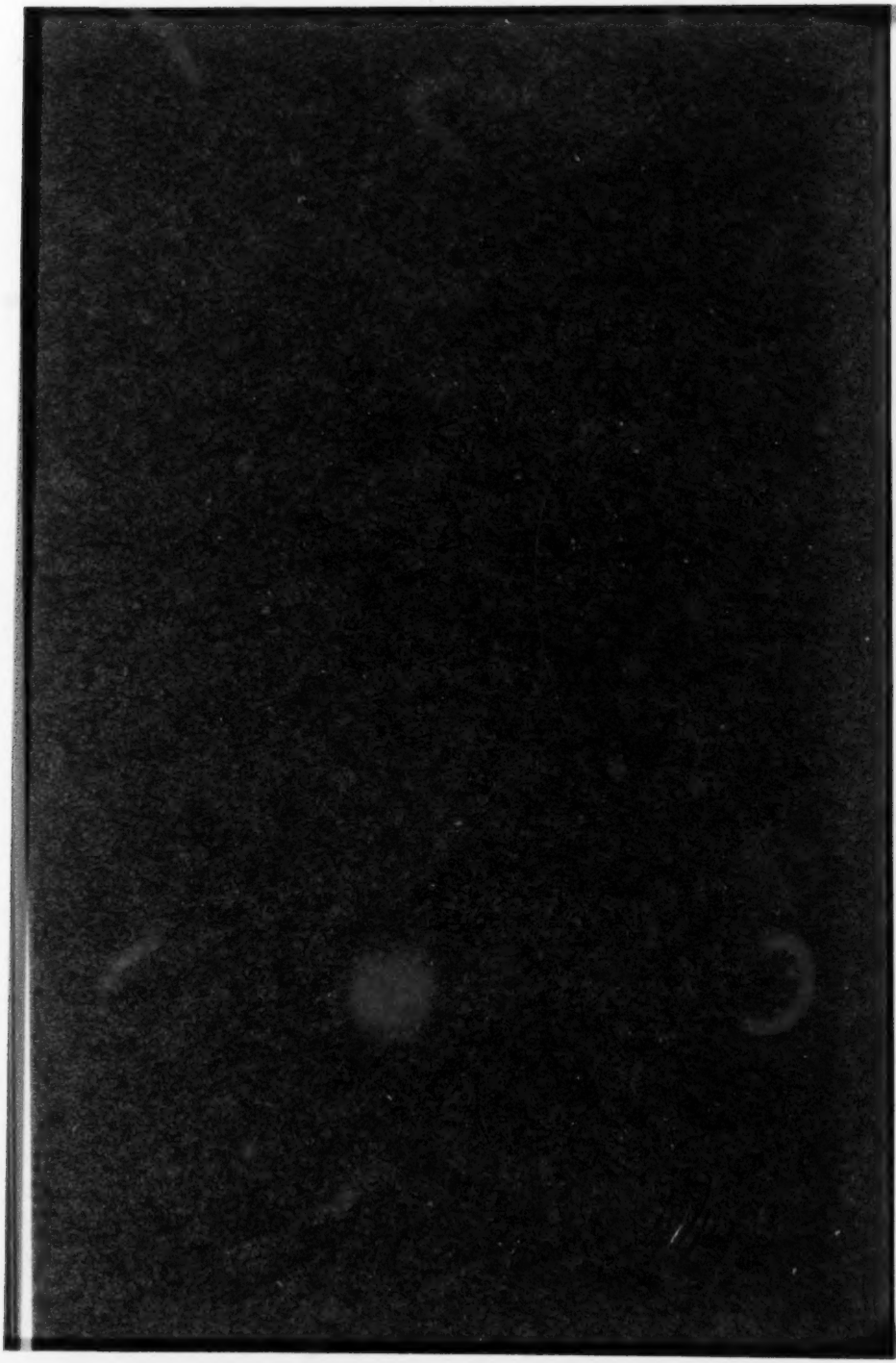

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 865

HAFENREFFER BREWING COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 23–41) is reported in 41 B. T. A. 443. The opinion of the Circuit Court of Appeals (R. 50–63) is reported in 116 F. (2d) 465.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 23, 1940 (R. 64). A petition for rehearing was denied on January 7, 1941 (R. 64). The petition for a writ of certiorari

was filed on March 22, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether in computing the taxpayer's personal holding company surtax a certain sum which was used during 1934 to retire part of the taxpayer's preferred stock, pursuant to a contract entered into in 1930, is deductible as an amount "used or set aside to retire indebtedness incurred prior to January 1, 1934," within the meaning of Section 351 of the Revenue Act of 1934 and the applicable Treasury Regulations.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra,* pp. 9–12.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 24–30) may be summarized as follows:

The taxpayer, a Massachusetts corporation organized in 1930, is a personal holding company within the meaning of Section 351 (b) (1) of the Revenue Act of 1934 (R. 24). At the time of its organization the taxpayer had a capitalization consisting of 7,000 shares of common stock of no par value and 5,900 shares of preferred stock of a par value of $100 each (R. 25).

The taxpayer's consolidated net earnings for 1933, as defined in its by-laws, were such that the taxpayer was required by the terms of a contract which it had entered into in 1930, and by the provisions of its preferred stock which it had issued in 1930, to set aside the sum of approximately $86,000 as a sinking fund for the purchase or redemption of its preferred stock. This sum was so set aside and applied to the retirement of the preferred stock during the taxable year 1934 (R. 29). Also during that year, the taxpayer paid a dividend out of its earnings of approximately $39,000 to the holders of its preferred stock (R. 29).

The taxpayer filed two federal tax returns for the year 1934, one a corporation income tax return and the other a personal holding company surtax return. In its surtax return, the taxpayer claimed as a deduction the amount which it had paid out during the taxable year in retirement of its preferred stock (R. 29–30). This deduction was disallowed by the Commissioner and a deficiency was assessed accordingly (R. 6–8). Taxpayer then filed a petition with the Board of Tax Appeals and, in an amendment to that petition, asserted that it was entitled to a deduction of approximately $39,000 in computing its income tax liability, which it had failed to assert in its return. This claim was predicated upon the dividend paid to the preferred stockholders, petitioner alleging that the dividend payment was in substance the payment of interest on indebtedness (R. 9, 30).

The Board of Tax Appeals decided that the holders of the preferred stock were stockholders rather than creditors and accordingly determined both issues in favor of the Commissioner (R. 30–39). Upon appeal, the taxpayer abandoned its claim that the $39,000 dividend payment was deductible as interest on indebtedness and pressed only its claim with regard to the $86,000 set aside for retirement of the preferred stock. The court below affirmed the decision of the Board (R. 64).

ARGUMENT

The decision of the court below that the sum set aside for the sinking fund was not "used or set aside to retire indebtedness incurred prior to January 1, 1934", within the meaning of Section 351 (b) (2) (B) of the Revenue Act of 1934, is clearly correct and is not in conflict with the decision of any other Circuit Court of Appeals.

The preferred stock plainly did not represent an "indebtedness" of the taxpayer within the meaning of the statute. The stock had no fixed maturity, a feature almost always present where there is a debtor-creditor relationship and the absence of which is persuasive evidence that no such relationship exists. *United States* v. *South Georgia Ry. Co.*, 107 F. (2d) 3, 5 (C. C. A. 5th); *Jewel Tea Co.* v. *United States*, 90 F. (2d) 451, 453 (C. C. A. 2d); *Commissioner* v. *O. P. P. Holding Corp.*, 76 F. (2d) 11, 12 (C. C. A. 2d); *Commissioner* v. *Schmoll Fils Associated*, 110 F. (2d) 611

(C. C. A. 2d); *Finance & Investment Corp.* v. *Burnet,* 57 F. (2d) 444 (App. D. C.). Furthermore, the dividends on the stock were payable only out of earnings, a feature tending to show a capital investment rather than an indebtedness. *Finance & Investment Corp.* v. *Burnet, supra; Elko Lamoille Power Co.* v. *Commissioner,* 50 F. (2d) 595 (C. C. A. 9th); *Warren* v. *King,* 108 U. S. 389, 399; *Hamlin* v. *Toledo, St. L. & K. C. R. Co.,* 78 Fed. 664 (C. C. A. 6th); *Hazel Atlas Glass Co.* v. *Van Dyk & Reeves,* 8 F. (2d) 716 (C. C. A. 2d), certiorari denied, *sub nom. Van Dyk* v. *Young,* 269 U. S. 570. And the rate of return on the stock was not even fixed. The rate of seven percent was to be paid for the years 1930, 1931 and 1932, but in later years the rate was seven percent or an amount representing one-half of the net earnings of the company available for dividends, whichever should be the lesser amount (R. 25).

The Treasury Regulations clearly show that such stock does not constitute an "indebtedness." Article 351–4 of Regulations 86, relating to the Revenue Act of 1934, provides in part that the term "indebtedness" means an obligation, absolute and not contingent, to pay, on demand or within a given time, in cash or other medium, a fixed amount; also that the term "indebtedness" does not include the obligation of a corporation on its capital stock. Since Section 351 (b) (2) (B) was reenacted in the Revenue Acts of 1936, 1937 and

1938[1] without substantial change, this Regulation must be deemed to have received legislative sanction.

There is no merit in petitioner's alternative contention that, even if the preferred stock does not constitute an indebtedness, the contractual obligation to retire some of the stock is such an indebtedness and the fulfillment of that obligation constitutes a "retirement" of the indebtedness. With respect to this contention, the court below stated (R. 56–57):

> To say that the retirement of the preferred stock is not the retirement of an indebtedness, but that the retirement of the obligation to retire the preferred is a retirement of an indebtedness does not seem reasonable. The argument would seem to involve the acceptance of the proposition that though the retirement of preferred stock is not the retirement of indebtedness, still if a board of directors should adopt an enforceable resolution providing for the retirement of certain shares, the fulfilling of the resolution would allow a deduction as the retirement of an indebtedness. Such a result seems to indicate that the argument is more ingenious than sound. Cf. *In re Piccadilly Realty Co.*, 78 F. (2d) 257, 261 (C. C. A. 7th, 1935).

It should be noted that if the taxpayer's position were sound, it would mean that, because a divi-

[1] Section 351 (b) (2) (B) of the Revenue Act of 1936, c. 690, 49 Stat. 1648; Section 355 (b) of the Revenue Act of 1937, c. 815, 50 Stat. 813; Section 405 (b) of the Revenue Act of 1938, c. 289, 52 Stat. 447.

dend declaration creates a debtor-creditor relationship between the corporation and its stockholders, the payment of the dividend could be treated as a retirement of an indebtedness and thus serve as the basis of a deduction. Even the taxpayer does not go that far; he refrains from urging that a debtor-creditor relationship arose on account of the dividend of approximately $39,000 paid on the preferred stock during the tax year.

There is no conflict with *Commissioner* v. *Tennessee Co.*, 111 F. (2d) 678 (C. C. A. 3d). In that case the taxpayer issued certain promissory notes prior to January 1, 1934, which were payable out of earnings and had no fixed maturity date. The court held that the notes evidenced an indebtedness within the meaning of Section 351 (b) (2) (B) even though the obligation was contingent.[2] In this case, the sinking fund was used to retire preferred stock, not promissory notes, and the provisions relating to the sinking fund are quite different from the terms of the promissory notes in the *Tennessee Co.* case. Moreover, in the *Tennessee Co.* case the interest rate was fixed; the rate of return in this case was not fixed. (R. 25.)

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The case is not

[2] Apparently, the court's attention was not invited to the amended Treasury ruling (T. D. 4777, *infra*, p. 10) which expressly provided that the obligation must be absolute, and not contingent.

of general importance because it turns upon its own particular facts. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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APRIL, 1941.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 351. SURTAX ON PERSONAL HOLDING COMPANIES.

* * * * *

(b) *Definitions.*—As used in this title—

* * * * *

(2) The term "undistributed adjusted net income" means the adjusted net income minus the sum of:

* * * * *

(B) Amounts used or set aside to retire indebtedness incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness; and

* * * * *

(U. S. C., Title 26, Sec. 331.)

Treasury Regulations 86, relating to the Revenue Act of 1934:

ART. 351–4. *Amounts used or set aside to retire indebtedness incurred prior to January 1, 1934.*—If, pursuant to a bona fide plan for retirement of its bonds, debentures, or similar obligations representing indebtedness incurred prior to January 1, 1934, for the purpose of raising capital (or assumed prior to that date in connection with the acquisition of capital assets by which such indebtedness is secured) the taxpayer—

(1) retires during the taxable year an amount of such indebtedness, or

(2) establishes a sinking fund or reserve for the retirement of such indebtedness during the taxable year, and sets aside in such fund or reserve an amount for the retirement of such indebtedness—

in determining the undistributed adjusted net income for the taxable year a deduction from the adjusted net income is allowable in a reasonable amount in respect of the amount so paid or set aside in such fund or reserve during the taxable year.

* * * * *

A resolution, specifying the particular indebtedness to be retired, the plan of retirement, and the specific assets to be used for that purpose, passed by the board of directors or corresponding authority during the taxable period or prior thereto, will be considered sufficient to meet the statutory requirement that the amounts must be "set aside". A certified copy of such resolution must accompany the return on Form 1120H.

The burden of proof will rest upon the taxpayer to sustain the deduction claimed.

* * *

ART. 351–4. [As amended by T. D. 4777, 1937–2 Cum. Bull. 196] *Amounts used or set aside to retire indebtedness incurred prior to January 1, 1934.*—(a) *Indebtedness.*—The term "indebtedness" means an obligation, absolute and not contingent, to pay, on demand or within a given time, in cash or other medium, a fixed amount. The term "indebtedness" does not include the obligation of a corporation on its capital stock.

The indebtedness must have been incurred (or, if incurred by assumption, assumed) by the taxpayer prior to January

1, 1934. An indebtedness evidenced by bonds, notes, or other obligations issued by a corporation is ordinarily incurred as of the date such obligations are issued and the amount of such indebtedness is the amount represented by the face value of the obligations. In the case of renewal or other changes in the form of an indebtedness, so long as the relationship of debtor and creditor continues between the taxpayer and his creditor, the giving of a new promise to pay by the taxpayer will not have the effect of changing the date the indebtedness was incurred.

(b) *Amounts used or set aside.*—The deduction is allowable, in any taxable year, only for amounts used or set aside in that year. The use or setting aside must be to effect the extinguishment or discharge of indebtedness. Since, therefore, in the case of renewal and other changes in the form of an indebtedness, the relationship of debtor and creditor continues between the taxpayer and his creditor, the mere giving of a new promise to pay by the taxpayer will not result in an allowable deduction. If amounts are set aside in one year, no deduction is allowable for such amounts for a later year in which actually paid. As long as all other conditions are satisfied, the aggregate amount allowable as a deduction for any taxable year includes all amounts (from whatever source) used and, as well, all amounts (from whatever source) set aside, irrespective of whether in cash or other medium. Double deductions are not permitted.

A resolution, specifying the particular indebtedness to be retired, the plan of retirement, and the specific assets to be used for

that purpose, passed by the board of directors or corresponding authority during the taxable period or prior thereto, will be considered sufficient to meet the statutory requirement that the amounts must be "set aside." A certified copy of such resolution must accompany the return on Form 1120 H.

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(d) *General.*—The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, the taxpayer must furnish the information required by the return, and such other information as the Commissioner may require in substantiation of the deduction claimed.

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